Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Margett	Analyst:	Raul Guzman	Bill Number:	SB 139
Related Bills:	See Legislative History	Telephone:	845-4624	Amended Date:	03/17/2005
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Long-Term Care or Long-Term Care Insurance Credit

SUMMARY

This bill would allow a credit to taxpayers who purchase long-term care or long-term care insurance.

SUMMARY OF AMENDMENTS

The March 17, 2005, amendments added several co-authors and corrected a technical error. The bill as introduced February 2, 2005, proposed the credit as described above in the SUMMARY.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the author's office, the intent of this bill is to help those individuals who incur the expense of long-term care or long-term care insurance.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. It would be operative for taxable years beginning on or after January 1, 2005.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law defines "qualified long-term care services" to mean services necessary to diagnose, prevent, cure, treat, mitigate, rehabilitate, and maintain or provide personal services to a chronically ill individual.

A chronically ill individual is generally defined as an individual certified annually by a licensed health care practitioner as unable to perform without substantial assistance at least two of the following activities of daily living (ADLs): eating, toileting, transferring, bathing, dressing, and continence. A chronically ill individual also includes someone who requires substantial supervision to be protected from health and safety concerns due to severe cognitive impairment.

Board Position:			Department Director	Date
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Federal law defines "long-term care insurance" to mean any insurance contract that provides coverage specifically for qualified long-term care services.

Current federal law specifically allows a deduction for medical expenses for the unreimbursed expenses for qualified long-term services provided to the taxpayer, the taxpayer's spouse, or the taxpayer's dependents. This deduction is only allowed as an itemized deduction and only to the extent it exceeds 7.5% of the taxpayer's adjusted gross income.

Long-term care insurance premiums are deductible on a graduated scale based on the individual's age before the close of the taxable year. The amounts shown below are for 2004 taxable year. These amounts are increased annually based on the medical care component of the consumer price index (CPI).

Age of Individual	Maximum Deduction
40 or less	$260
More than 40 but less than 50	$490
More than 50 but less than 60	$980
More than 60 but less than 70	$2,600
More than 70	$3,250

Current California law conforms to these federal tax provisions related to long-term care.

California law also allows a tax credit to eligible caregivers. The credit is $500 for each qualifying individual who has been certified to need long-term care. A qualifying individual may be the taxpayer, the spouse of the taxpayer, or a qualified dependent, as defined. The credit is not allowed to any eligible caregiver whose adjusted gross income is $100,000 or more. This credit is allowed for taxable years beginning on or after January 1, 2000, and before January 1, 2005.

"Qualified dependent" includes any individual who may be claimed by the taxpayer as a dependent on the taxpayer's income tax return. This would include the taxpayer's children, adopted children, and parents of the taxpayer.

THIS BILL

This bill would allow a credit equal to 30% of the amount paid or incurred by the taxpayer during the taxable year for the cost of the long-term care or long-term care insurance. The credit would not exceed $300 per taxpayer or $600 for taxpayers filing jointly. This bill would allow the taxpayer to qualify for this credit if long-term care or long-term care insurance is provided to the taxpayer or any parent of the taxpayer.

This bill would define "long-term care" and "long-term care insurance" by reference to federal law as described above. "Parent" is defined as any natural, biological, or adoptive mother or father of the taxpayer.

This bill would require the provider of long-term care services to provide the taxpayer with written verification of services and payments received. Written verification would include the following information:

- Taxpayer's name,
- Payments received for the long-term care services,
- Name of the individual receiving the care, and
- Period services are provided.

The taxpayer would be required to provide the above information upon request of the Franchise Tax Board.

This bill would allow the credit to be carried forward indefinitely.

IMPLEMENTATION CONSIDERATIONS

As written, this bill could be interpreted to limit this credit to per taxpayer, rather than per eligible person (taxpayer, spouse, parents). For example, if a filing single taxpayer paid long-term care or long-term care insurance for himself and both of his parents, the maximum credit would be $300. However, if the taxpayer paid long-term care or long-term care insurance for only himself and files jointly, the maximum credit would be $600. The author may wish to clarify the intent of the bill.

THECNICAL CONSIDERATIONS

The following technical considerations were identified.

On page 2, line 15, the bill uses the term “board.” There are many “boards” in California government. To avoid confusion, the name of the intended board should be specified.

The terms “long-term care” and “long-term care insurance” are defined by reference to a subsection of IRC Section 7702B. The definitions and references should be more specific. The following changes are suggested: (1) “Long-term care” means long-term care services as defined in 7702B(c) of the Internal Revenue Code. (2) “Long-term care insurance ” means long-term care insurance as defined in 7702B(b) of the Internal Revenue Code.

LEGISLATIVE HISTORY

AB 247 (Walters, 05/06) contains language similar to the language contained in this bill. This bill is currently in the Revenue and Taxation Committee.

SB 121 (Margett, 03/04), AB 1523 (Garcia, 03/04), and SB 1691 (Margett, 01/02) all contained language similar to the language contained in this bill. SB 121 failed passage in the Senate Appropriations Committee. AB 1523 and SB 1691 failed to pass out of the legislature by the constitutional deadline.

AB 511 (Alquist, Ch. 107, Stats. 2000) created the tax credit for eligible caregivers discussed above under state law.

OTHER STATES’ INFORMATION

The laws of these states were reviewed because their tax laws are similar to California’s income tax laws.

Minnesota provides a credit of 25% of the premium paid for long-term care insurance during the taxable year. The credit may be up to $100 for single taxpayers or $200 if filing jointly.

New York provides a credit equal to 10% of the premium paid for long-term care insurance during the taxable year.

Illinois, Massachusetts, and *Michigan* do not provide a credit comparable to the credit that would be allowed by this bill.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Due to data limitations, it is only possible to provide generalized estimates for this bill. Based on limited data and assumptions discussed below, this bill would result in the following order of magnitude revenue losses.

Estimated Revenue Impact of SB 139 As Amended 3/17/2005 [$ In Millions]		
2005-06	2006-07	2007-08
-$120	-$145	-$170

Estimates assume that the proposed credit is in addition to any other existing tax benefits for costs incurred for long-term care or long-term care insurance.

Revenue Discussion

The revenue impact of this bill would be determined by amounts incurred for long-term care or long-term care insurance premiums by a taxpayer for the benefit of the taxpayer or a parent and the amount of credits that could be applied against tax liabilities. Estimated annual revenue losses consist of two components: taxpayers currently paying for some form of long-term care and taxpayers paying premiums for long-term care insurance.

Long-Term Care Component

According to the Department of Aging, there are about 100,000 individuals in long-term care facilities in California. Medicare or private insurance covers approximately one-third of these individuals [100,000 x 1/3 = 33,000], Medi-Cal covers the others. If one-half of those covered by Medicare or private insurance are taxpayers [33,000 x 1/2 = 16,500] and have a tax liability to apply the maximum proposed credit of $300 or $600, revenue losses would be on the order of $5 million [16,500 taxpayers multiplied by an average credit of $300 = $4.9 million]. Those individuals receiving care in assisted-living facilities, adult day health care facilities, or in the home could exceed 100,000. The revenue loss impact for the latter categories could approach $30 million [100,000 taxpayers multiplied by an average credit of $300 = $30 million].

Long-Term Care Insurance Component

The insurance component of the proposed credit was derived by (1) projecting the net number of policies in force each year by California resident taxpayers after applying an "inducement to purchase" factor beginning in the second year for the proposed incentive credit, and (2) multiplying the number of policies by 30% times the average annual premium of $1,700 up to a maximum of $300. The revenue loss for this component for the first year is projected to be on the order of $150 million [500,000 policies times an average credit of $300 = $150 million].

Based on national data, the number of policies in force in California is projected at roughly 500,000 by 2005 and grows to 560,000 by 2006 after applying an inducement to purchase factor beginning in the second year. An average annually premium of $1,700 is used for the estimate. According to industry contacts, most long-term care insurance premiums range from $1,000 to $3,000 annually.

Combined Discussion

Adding revenue effects for the long-term care and the long-term care insurance components results in potential losses of $185 million [$5 million + $30 million + $150 million = $185 million]. Multiplying the $185 million by a participation rate of 65% in the initial tax year derives an estimate of $120 million. The participation rate increases each subsequent year until eventually nearing 100%. It is assumed all credits generated are applied in the year generated.

The final step is to convert taxable year estimates to cash flow estimates above. Cash-flow estimates reflect the ability of some taxpayers to accelerate tax benefits by adjusting their estimated tax payments.

POLICY CONCERNS

This bill would allow a new credit for natural or adopted parents, even if the parents were not a dependent of the taxpayer. The current medical expense deduction is allowed on natural or adopted parents or in-laws if the parent is a dependent. As a result, the same expenses could be claimed for both the credit and the deduction. The author may wish to make this credit in lieu of the deduction.

Unlike the current eligible caregiver credit, this bill does not include dependents or children in need of long-term care. As a result, the taxpayer's long-term care expenses for dependents or children would not qualify for this credit. This would treat taxpayers with the same type of long-term care expenses differently. Taxpayers with children that require long-term care may feel this bill is inequitable.
This bill does not include a sunset date. Sunset dates generally are provided to allow periodic review by the legislature of the credit's effectiveness.

This bill would allow an indefinite credit carryover period. As a result, the department would be required to retain the carryover on the tax forms indefinitely. Most credits include a time limit by which any available credit must be applied against income tax. Credits are typically used within eight years of being earned.

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